



Moody's Investors Service

Global Credit Research

New Issue

29 MAR 2004

New Issue: Honolulu (City & County of) HI

MOODY'S ASSIGNS Aa2 RATING TO CITY AND COUNTY OF HONOLULU (HI) GENERAL OBLIGATION BONDS; CREDIT OUTLOOK IS STABLE

Approximately \$1.8 Billion of G.O. Debt Affected

Municipality
HI

Moody's Rating

ISSUE	RATING
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General Obligation Bonds, Series 2004A	Aa2
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Sale Amount \$130,350,000

Expected Sale Date 03/31/04

Rating Description General Obligation Bonds

General Obligation Bonds, Series 2004B	Aa2
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Sale Amount \$120,460,000

Expected Sale Date 03/31/04

Rating Description General Obligation Bonds

General Obligation Bonds, Series 2004C	Aa2
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Sale Amount \$5,700,000

Expected Sale Date 03/31/04

Rating Description General Obligation Bonds

Moody's Outlook Stable

Opinion

NEW YORK, Mar 29, 2004 -- Moody's Investors Service has assigned an Aa2 rating and stable outlook to the City and County of Honolulu's General Obligation Bonds, Series 2004A, Series 2004B and Series 2004C to be issued in the approximate amount of \$259.0 million. The bonds will refund approximately \$256.6 million of the city's outstanding general obligation bonds for debt service savings. In conjunction with the current credit review, Moody's has also affirmed the Aa2 rating and stable outlook on the city's \$1.8 billion of outstanding general obligation bonds. The bonds are secured by an unlimited property tax pledge; debt service payments represent a first charge on the city's General Fund. The Aa2 rating primarily reflects the city's solid economic rebound following post-9/11 lows in the tourism industry, rising real estate values on Oahu which have spurred steady growth in assessed valuation, the city's sound financial performance which reflects management's ability to control spending and raise property tax rates when needed, and a manageable debt profile.

ROBUST ECONOMIC PERFORMANCE FOLLOWING POST-9/11 DECLINES IN TOURISM

In contrast with the national economy, Honolulu's economy has performed remarkably well in recent years, particularly given the sharp declines in travel to Hawaii following the 9/11 terrorist attacks. Unemployment remains relatively low in Honolulu at 3.5% in December 2003 compared with 3.8% for the State of Hawaii

and 5.4% for the nation. Rising real estate values have had an important influence on the local economy, but a variety of other factors have contributed as well. Visitor traffic has stabilized following the steep declines suffered immediately following the 9/11 terrorist attacks. Eastbound (primarily Asian) and other international traffic remain down, but Westbound traffic (primarily from the U.S. West and East coast markets) has largely offset these losses. Hawaii remains a unique and attractive tourist destination and officials have been successful in niche marketing the island. Examples include sports- and eco-tourism as well as a growing inter-island cruise business, all of which attract a higher percentage of first time visitors and stimulate longer average stays. Moody's notes that airline capacity serving the Hawaii tourism market relies on the health of the financially volatile airline industry. Moody's also notes improving economic diversity in the Honolulu economy which includes the military, health care, and banking sectors as important contributors to the local economy. Despite the moderating influence of many tourism-related service jobs, wealth indicators in Honolulu are also favorable with per capita and median family income at 101.9% and 120.1% of the U.S., respectively.

STRONG OAHU REAL ESTATE MARKET SUPPORTS CONTINUING TREND OF ASSESSED VALUATION GROWTH

An important element of Honolulu's economic stability has been the rather robust Oahu real estate market which has led to steadily growing assessed values since 2001. Following a period of rapid escalation in property values in the late 1980s and early 1990s Honolulu's tax base experienced significant erosion from 1996 through 2001, losing almost one-fifth of its value during that period. However, since bottoming out in 2001, assessed valuation has grown by an average of 4.9% annually, achieving a substantial \$79.2 billion in 2004; preliminary estimates point to a robust 15% growth in assessed valuation for 2005. Residential, commercial and industrial real estate have all contributed to the growth, which should continue to translate into rising taxable values over the near term given the lag between real estate prices and assessed valuation. Moody's also notes that the current real estate market shows no signs of the type of speculative bubble which occurred in the early 1990s. Honolulu's 2004 assessed value per capita totals an impressive \$90,343 and points to an unusually wealthy tax base.

SOUND FINANCIAL PERFORMANCE REFLECTS CITY'S DISCIPLINED APPROACH TO SPENDING AND A WILLINGNESS TO INCREASE TAXES

The city's financial performance has improved notably in recent years, due in large part to management's willingness to raise property tax rates as needed, combined with the city's successful multi-year effort to control expenditures. Recent growth in assessed valuation is particularly significant to the city's credit profile in that property tax revenues represent approximately two-thirds of operating revenues. Just as important, however, is the city's willingness to raise tax rates to fund increasing fixed costs such as pension, health and debt service expenditures. In addition, a variety of cost cutting measures such as workforce reductions, department consolidations, hiring freezes and increasing self-support for enterprise activities, have resulted in relatively flat expenditure growth over time. As a result, management's commitment to maintaining budget balance and improving reserves has been increasingly evident and continues to be an important factor in Moody's credit evaluation of Honolulu.

Audited financial results for fiscal 2003 indicate an \$18.5 million operating surplus in the General Fund which resulted in total fund balance of \$72.8 million, or 10.9% of General Fund revenues; unreserved fund balance totaled \$51.5 million, or 7.7% of revenues. Though the city lacks a formal reserve policy, city staff targets a minimum 5% unreserved General Fund balance. The city's favorable fiscal 2002 and 2003 performance follows an understandably difficult 2001 which included 9/11-related declines in transient accommodations tax receipts as well as higher spending requirements, especially for public safety. Nevertheless, the city has posted significant operating surpluses in four of the five audited years since 1999. The city also maintains a \$5 million rainy day fund outside the General Fund, providing additional flexibility.

Going forward, Moody's believes that the city's financial position should remain stable as it benefits from a combination of growing tax revenues and the ongoing savings associated with structural spending reforms implemented in recent years. Nevertheless, it remains likely that Honolulu will continue to face its share of budget challenges in the near term, in part due to the rising pension and health costs mentioned above. The city's fiscal 2004 budget includes a property tax rate increase to fund such cost increases. Despite these ongoing budget issues, Moody's believes that the city's demonstrated ability to manage its finances well under difficult circumstances bodes well for future financial stability, especially in light of anticipated revenue growth.

MANAGEABLE DEBT POSITION MODERATED BY REASONABLE BORROWING PROGRAM AND GROWING TAX BASE

Moody's expects that Honolulu's debt levels will continue to remain manageable given reasonable borrowing assumptions and the expectation of continued tax base growth in the near term. In addition, Honolulu benefits from the active role the state government plays in financing traditional municipal capital needs more typically funded at the local level throughout the rest of the country including transportation, health, justice, and education.

Management has begun to fund the construction activities of various enterprise systems from system rates rather than property taxes. As a result, future borrowings will emphasize revenue bond offerings rather than general obligation issuances. Debt burden measures compare favorably to other cities and counties in the U. S. with overall debt representing only 1.9% of fiscal 2004 taxable values. Including the current offering, the city has approximately \$1.83 billion of outstanding general obligation bonds and about \$558 million of remaining unissued authorization. Approximately 53.3% of the city's outstanding general obligation debt is retired in ten years.

Outlook

The stable rating outlook for Honolulu reflects Moody's expectation that the city's economy will continue to perform well and that assessed valuation will grow further in the near-term. The stable credit outlook also incorporates Moody's expectation that city management will continue to take the actions necessary to ensure fiscal stability in light of rising pension and health costs over the near- to medium-term.

KEY STATISTICS

2000 population: 876,156

1999 per capita income: \$21,998 (101.9% of U.S.)

1999 median family income: \$60,118 (120.1% of U.S.)

2004 full valuation: \$79.2 billion

Direct and overall debt burden: 1.9%

Payout of principal, 10 years: 53.3%

FY 2003 total General Fund balance: \$72.8 million (10.9% of General Fund revenues)

FY 2003 unreserved General Fund balance: \$51.5 million (7.7% of General Fund revenues)

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